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ABSTRACT

This paper analyzes the reasons behind the success and failure of various entrepreneurs and their small businesses. Presented first is an overview of the increasing role of entrepreneurship as a way of earning a living in the United States today and the different challenges and outcomes new small business generally encounter. In the first three sections, the personal characteristics of typical entrepreneurs are outlined, as well as types of motivation and preparation for entrepreneurship. Three case studies examine small businesses that eventually turned out to be very successful, moderately successful, and not at all successful. The final two sections of the brochure discuss some of the many factors that determine the success or failure of a new enterprise. (MN)

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Entrepreneurship: Starting a New Business

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In America, every person is free to start a business, and a surprising number take advantage of that opportunity. This is reflected in the great number of new firms started every year. As many as 8,400 new corporations are started in a typical week.

For the person starting a business, the decision can represent a major commitment. It may involve quitting a job, working long hours, investing savings, and borrowing from relatives or banks. Whether the business is successful or not, the person's life may be different from that time onward.

For society, this flow of new businesses can provide many benefits. New businesses can offer additional choices to consumers. For instance, a new restaurant might offer a different menu, or lower prices, or a more convenient location. New businesses can also provide jobs. Recent research indicates that 80% of the new jobs created during the period 1969-1976 were created in firms which were less than five years old.[1] Furthermore, these job opportunities may be particularly attractive to those people who are most happy and effective in a small business environment. New businesses can also be centers of innovation. They are not tied to existing ways of doing things. Available evidence suggests that a high percentage of the most significant inventions have originated in small firms.[2] New firms challenge older established businesses in many ways, causing them to become more efficient and more responsive to consumer needs.

However, at the same time that all of these new firms are being created, many others are going out of business. It appears that about two out of three new firms close their doors within four years of their founding.[3] In every community there are some store fronts on which a new sign goes up every six months, as a new entrepreneur tries to get a business started. Some of these stores seem to need revolving doors—not for customers, because there aren't many, but for the company founders as they come and go.

Many of the businesses which close down have been failures from the start. Others have been successful in the past, possibly supporting the owner and family for many years. However, conditions can change. The owner may choose to retire. The industry or the neighborhood may become less attractive, so that the owner decides to enter a different kind of business.

For the businesses which are founded and survive, there are different degrees of success. Many new firms have very few employees and primarily provide a living for the founder and members of the family. These small businesses may have founders who have technical skills such as being able to style hair, or repair automobiles, or do electrical contracting. The business may be started to permit the founder to practice his or her trade. As such, it is unlikely to experience much growth.

Other new businesses grow to become what might be called "stable, high-payoff" firms. They may be set up to serve a local market, as with the local Chevrolet dealership or McDonald's franchise. These businesses are often large enough so that additional managers can be hired. They are usually much more profitable than the businesses built around the owner's trade. However, they also require more capital to start and more management skills to run successfully.

A few new businesses become "high-growth firms." Almost every large company in the United States was once a new firm. Companies such as Polaroid or Xerox or Texas Instruments were once young and small. These high-growth companies usually are located in industries which are growing rapidly. Their growth requires that the owners take risks in introducing new products, in borrowing

[1] David L. Birch, **The Job Generation Process**, (Cambridge, MA: M.I.T. Program on Neighborhood and Regional Change, 1979).

[2] **Advisory Committee on Industrial Innovation: Final Report** (Washington, D.C., U.S. Government Printing Office, 1979).

[3] **Patterns for Success in Managing a Business**, Dun and Bradstreet, New York, 1967.

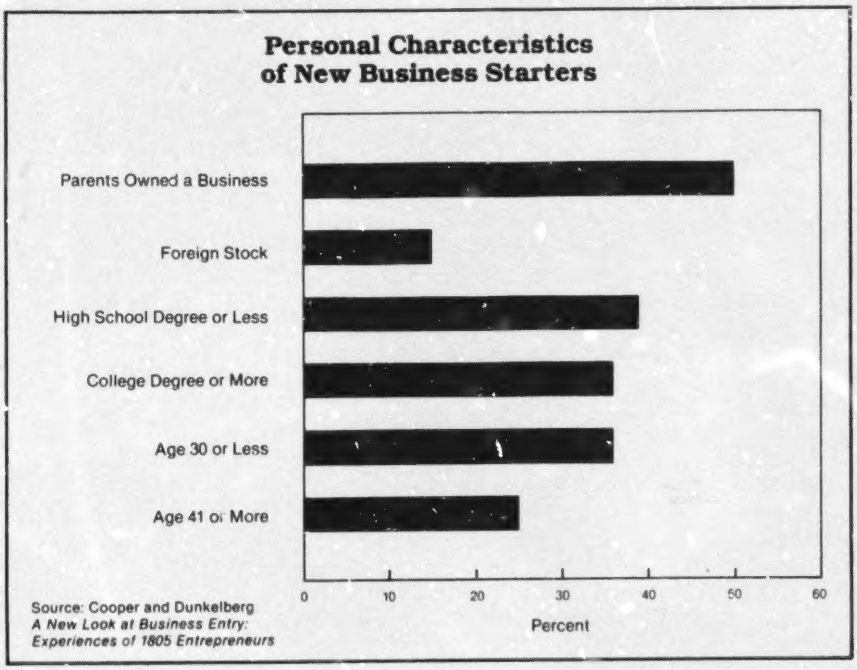
Entrepreneurship: Starting a New Business

money to build new factories or stores, and in adding new people to their organizations. When successfully managed, these businesses can make their founders wealthy.

There are about 14 million businesses in this country. Most are small and many are new. However, the individual businesses which make up this sea of firms are constantly changing. They are starting, closing, and being acquired. Many are succeeding modestly, and some are achieving outstanding success. We shall now consider how these companies get started.

Entrepreneurs

There are some who think that people who start businesses—entrepreneurs—are "born, not made." Yet, the study of company founders suggests that a variety of experiences which people have may make them more or less likely to start their own businesses. These experiences may involve their families, or take place in school or on the job.



One major influence is the family. People who start companies are more likely to come from families in which their parents or close relatives were in business for themselves. These older people were examples or "models" for the children. Whether they were successful or not probably didn't matter. However, for the children growing up in such a family, the action of starting a new business seems possible—something they can do.

In the same way, many cultural groups, such as Jews in America, or Cuban immigrants in Miami, or the Chinese in Southeast Asia have a tradition of members starting new businesses. Sometimes, they have been prevented from working for others because of prejudice. Children growing up in such groups are surrounded by examples of entrepreneurship. They learn what is involved in working in businesses. It becomes easy for them to think of themselves as people who can start businesses also.

People who start companies seem to have certain psychological characteristics. They believe that they can control their own destinies. They are less likely to think that forces beyond their control, such as luck or fate, will determine their success. They believe that through their efforts, their determination, and their hard work they can make their businesses succeed.

Many entrepreneurs also tend to be goal-setters. They gain satisfaction from setting goals which are moderately challenging (but not impossibly difficult) and then achieving those goals. They see themselves as taking moderate risks in achieving their goals. To an outside observer, the process of starting a firm may seem to involve enormous risks. However, to the entrepreneur, who believes that he or she can make that business successful, the risks seem more moderate.

The age of the founder at the time he or she is interested in starting a business is also a factor. People of all ages start businesses, but many are in the age range of about 25 to 40. Younger people might have strong desires to start businesses, but often do not have the money or experience needed. Older people may have money and experience, but they also often have obligations to support families and may be reluctant to risk what they have achieved.

So we see that some backgrounds are most typical for entrepreneurs. However, this does not mean that people with other backgrounds cannot or do not start businesses. It is just that a certain background may make a person more prepared—more likely to take the step if the right opportunity arises.

All of this suggests that some people are more likely to start new businesses than others. Whether they actually do depends upon other factors which we shall now consider.

Entrepreneurship: Starting a New Business

Motivation

Many people have the backgrounds and psychological makeups which could lead them to start new firms. Yet only some of these people ever take the step of giving up a job and investing their time and money in a new business.

One factor at work here involves what might be called dislocations or pushes. These are forces which cause a person to move out of a comfortable "rut." Why should anyone give up the security of a job for the uncertainties of trying to get a business started? It helps if the person is at a time of change—if the decision has already been made to give up a previous job or an existing lifestyle. Thus, immigrants such as the Cubans who have come to Miami are at a point of change in their lives. Workers who lose their jobs because of layoffs must decide what they will do next. Managers who are frustrated because their companies turn down their ideas or because they don't get a desired promotion may be determined to make a change. Often, a specific event will "trigger" the change. A person may foresee an approaching birthday and think, "I'll soon be forty. It's now or never." Or, a fight with the boss may move a person to a stage in which he or she begins to think, "What will I do next?"

Of course, most people who make changes in their lives don't start new businesses. Those who do take this step often have the characteristics listed earlier. They may also be influenced by what they know of others who have started businesses. If these are people they can identify with—relatives, fellow-employees, or friends—they are more likely to see this as something that they can do. Some families have a history of entrepreneurship; some industries, such as advertising, or construction, or the manufacture of electronic components, are noted for a high birth rate of new firms; some organizations have many employees leaving to start new firms. People who are involved in such families, industries, or organizations are surrounded by examples of what is involved in starting a company. Not only can they learn from others, they can see what is involved. For them, it is psychologically easier to take this step.

Preparation

Many people may wish to start businesses, but they are unable to do so. They lack the experience, the contacts, or the resources which are needed. A new company is very much built around the entrepreneur. The owner-manager must be able to perform those key activities which are required for success. If it is a clothing store, the manager must be good at buying the right merchandise, as well as displaying, advertising, and pricing it. The manager must also be able to do the selling (or train others to do it) and handle the record-keeping, paying of suppliers, etc. An alert employee of a clothing store can learn many of these needed skills and become capable of starting a successful clothing store. People often start businesses in fields they already know in order to draw upon their previous backgrounds.

Thus, we might think of established organizations as "incubators," giving their employees experiences which make them more or less prepared to become entrepreneurs. However, industries vary widely in the extent to which they provide promising environments for new firms. If large organizations and heavy capital investments are required, then it would be difficult for an entrepreneur to assemble the needed resources. Thus, we see very few new automobile manufacturers being planned. An employee of a steel mill, no matter how motivated, would find it difficult to start a similar business because of the capital requirements. If industry sales are not growing, it is difficult for a new firm to get established because then it must take sales away from established businesses. Accordingly, we do not see new railroads being organized to participate in the declining railroad industry.

By contrast, in growing industries with low capital requirements, we can observe many new firms being organized. Examples are companies producing computer software and solar power equipment. For the same reasons, an experienced real estate salesman in a growing metropolitan area might find it relatively easy to spin off and start a new firm.

We should also note that, even within the same organization, employees develop different kinds of experience. Some stay in the same job and never achieve much breadth in experience or contacts. Others become specialists, good in their jobs, but narrow and lacking in the basic skills needed to produce or sell a product and get a company started. Some employees are in better positions to develop external contacts and to learn about market opportunities. Thus, an industrial salesman may learn that customers would buy a particular product if only it were available. The salesman may conclude that a new company could get started by offering that product.

All of this is not to suggest that an entrepreneur cannot start a firm in a field in which he or she has no experience. It happens every day. If the founder gets started by buying an existing business or by entering into an agreement with a franchisor (such as McDonald's or Baskin-Robbins), then previous experience is less important. However, available evidence suggests that more than 50% of all entrepreneurs start businesses in industries in which they already have experience. The previous educational

and job choices which a person makes help to determine what kind of business, if any, he or she might someday be in a position to start.

Educational background also influences whether a person might be prepared to start particular kinds of businesses. The person who does not understand computers is not prepared to start a computer software company. The person who cannot analyze financial statements would find it difficult to raise capital from investors or banks for a large venture. Formal education can help to prepare the entrepreneur. Thus, the decisions a person makes about education help to determine those future opportunities which may be open.

Motivation and preparation are not enough. Most new businesses require capital—sometimes lots of it. In 1980, a McDonald's franchise required several hundred thousand dollars. Examples of other capital intensive ventures include racquetball clubs, motel complexes, automobile dealerships, and many manufacturing companies. The capital requirements depend upon the nature of the industry and upon the initial plans of the founder.

Industries vary in their capital requirements. For instance, utilities require big investments in generating equipment and power lines. By contrast, advertising agencies require only a desk, telephone, and some money for working capital to get started.

Even within a given industry, a founder can make plans which minimize capital requirements. For instance, a person starting a business to repair automobiles may rent a building rather than buy one and may postpone investment in repair equipment which is expensive and rarely used. Many manufacturing firms have started with used equipment in garages or lofts.

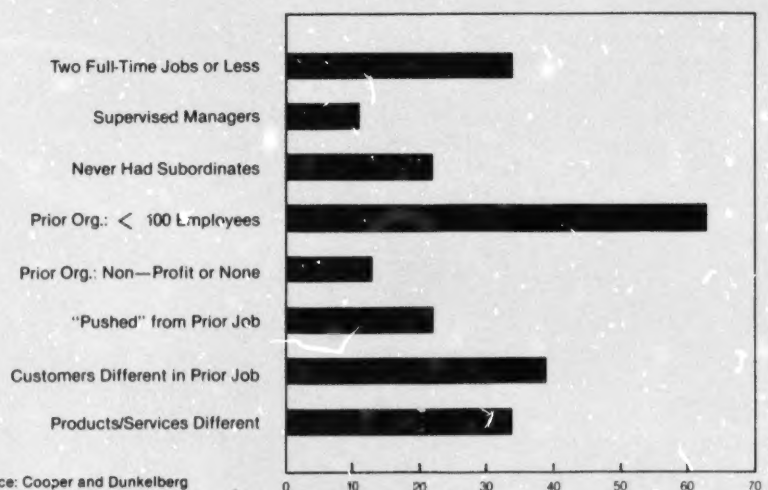
Where do company founders usually get the money to get started? Personal savings appear to be the most important source of funds. Loans from relatives and friends are also a common source. (It has sometimes been suggested that one of the best sources of venture capital is to choose your parents carefully.) Bank loans, which are so important for established small businesses, play a smaller role. One reason is that the new company has no record of accomplishment, by which a banker might judge the ability to repay. Loans may be easier to obtain when there is collateral, such as real estate, which can be sold to repay the loan if the venture is unsuccessful. Other sources of financing include credit from suppliers, who may ship goods, but be willing to accept payment at a later date.

Promising new companies with prospects for high growth may be able to raise venture capital from outside investors. This is more likely if the new business is in an industry experiencing rapid growth or current popularity in the stock market. Investors may then anticipate that they will make a later profit when the growing company sells stock to the public or is acquired by a larger firm.

An entrepreneur's ability to raise capital is by no means assured. Many new businesses have been dreamed up, but never brought into existence because the founder could not raise the needed capital. If the entrepreneur has a good "track record"—if he or she has the kind of record of success which inspires confidence—then chances for successful financing are improved. If the business plans are carefully investigated, then investors have more reason for confidence in the proposed business.

Many factors make a particular geographic region more or less favorable for starting new businesses. Regions vary in the extent to which there is local wealth which might be invested in new ventures. Local banks differ in the extent to which they might make loans for particular kinds of ventures. If, within a given region, investors and banks have successfully backed agricultural ventures in the past, then they may look with favor upon proposed new businesses related to agriculture. These same investors and lenders might be

Career Patterns of Business Starters: Prior Experiences



Source: Cooper and Dunkelberg
A New Look at Business Entry: Experiences of 1805 Entrepreneurs

very uncomfortable evaluating a proposed business to develop computer software.

Other factors also affect the regional climate for entrepreneurship. Easy access to suppliers and customers may be important. Thus, many tool and die shops have started around Detroit, where they can work closely with their customers in the automobile industry. A prosperous area experiencing population growth needs new stores, restaurants, apartments, etc. By contrast, the entrepreneur trying to start a retail store in a community with declining population must undertake the difficult task of taking sales away from established competitors.

Most people start businesses where they are already living and working. They can thereby use their local contacts and "feel" for the local market. It is then possible to start the business part time, or at least to avoid all the problems of moving a family and opening shop in another area. One implication is that the regional environment may or may not be supportive for starting a particular kind of business. Some would-be entrepreneurs are more favorably located than others.

The process of starting a firm begins with developing an idea or learning of an opportunity. The entrepreneur must then try to evaluate the proposed business, anticipating the investment needed, operating costs, competition, sales, and profits. Careful evaluation may involve a great deal of data-gathering, including talking to suppliers, prospective customers, and people who are knowledgeable about the industry. If the entrepreneur is already in contact with such people, investigation is simplified. Sometimes some aspects may be clearly determined, such as the rental cost of a store, while other aspects, such as expected sales, may remain highly uncertain. Some businesses can be started on a part-time basis or with a low investment; the founder can then get feedback from the marketplace in deciding whether to make a greater commitment. Other businesses require substantial investments before the first dollar of sales can be generated. Often, the entrepreneur will discover that the plans should be modified. Thus, a new restaurant offering ice cream and sandwiches may be changed to a steak house if initial sales are disappointing.

Despite these comments about careful investigation, we should recognize that many entrepreneurs push ahead impulsively, with little understanding of what they are getting into. Often, they lack the managerial skills to evaluate or run their new businesses. The result is that many new firms are unsuccessful.

CASE STUDIES

Case Study I: Go West, Young Man

Upon graduation from college, Bob Speake joined a small manufacturer of dry fertilizer spreaders located in Missouri. Although he had been hired as an accountant, his duties grew to include advertising, purchasing, sales, and service and repair. After four years with the company, he concluded that he could make more money as an independent distributor for the company in one of the neighboring states. His boss urged him to stay and offered a raise and participation in a profit-sharing plan. Bob Speake insisted on going ahead with his plans, so the company agreed to sell dry fertilizer spreaders and repair parts to him.

After a careful investigation of the market and competition in surrounding states, Bob decided to establish his business in South Dakota. He had less than $10,000 to invest in inventory and parts. Fortunately, his wife had a teaching job to support them as they got started. They used their apartment as an office and its basement for storing repair parts.

Sales were $198,000 in the first year. Bob and his wife rented a plant and hired the first workers to prepare spreaders for delivery and do repair work. Four years later, they designed a line of liquid fertilizer spreaders, which the company began to manufacture and sell. They continued to distribute dry fertilizer spreaders. Sales expanded as the company emphasized good service and quick repair of spreaders. (Because of corrosion from the fertilizer, breakdowns of spreaders were a common problem in the industry.) Twelve years after founding, the company had annual sales of $1.1 million.

Case Study II: If At First You Don't Succeed . . .

John Merriam, a civil engineer, worked with a construction firm in Detroit. The firm specialized in constructing single-family housing in the northern suburbs of the city. A decline in construction activity in 1974 caused his income to decline through loss of bonuses on projects he supervised. He decided to leave his employer and began to look seriously for other employment opportunities.

A friend suggested that he consider residential demolition, which involved contracting to tear

down obsolete or deteriorated housing. Existing firms seemed to concentrate on tearing down buildings as quickly as possible and hauling the debris to the dump. The friend suggested that he investigate the possibility of salvaging objects of value before tearing the houses down.

John Merriam's investigations disclosed that about 8,000 homes were wrecked in the area each year and that about 10% of these had been built with high-quality materials with real salvage value. He developed a plan to bid for the demolition of these homes and then salvage the copper pipes, electrical fixtures, hardwood floors and paneling, and other objects of value before demolition. He developed careful estimates of the time needed to do a job. He checked his estimates by bidding on one older house and demolishing it using rented equipment. It appeared that the business could be highly profitable, possibly generating pre-tax profits of $120,000 per year.

Mr. Merriam calculated that about $125,000 would be needed to start the business, including the purchase of two trucks and a used crawler tractor. Mr. and Mrs. Merriam only had $15,000 of their own and were unable to raise the additional $110,000, even though they talked to many banks and other financial institutions.

Subsequently, he modified his plans. Rather than investing in demolition equipment, he began to pay other wrecking companies for the right to go into houses first and to remove the antique hardware and hardwood paneling and flooring. The company then published a catalogue of antique building materials and sold to antique stores, interior decorators, and contractors. It has been very successful.

Case Study III: The One That Got Away

After receiving his M.B.A., David Simmons became an employee of a midwestern entrepreneur who was developing plans for various ventures in the leisure-time field. In this job, he began to work on plans to develop a resort campground in Puerto Rico. It would involve leasing ocean-front parkland from the Commonwealth of Puerto Rico and installing tent trailers permanently on the site.

David became excited about the possibilities for the venture, but increasingly disillusioned about the managerial ability and ethics of the entrepreneur for whom he worked. When this man disclosed that he was planning to dissolve their business, David obtained permission to pursue the Puerto Rican camping-resort venture on his own.

Over the next four months, David Simmons devoted full time to developing plans for the proposed business and to trying to raise the needed capital. He gathered market data on tourists visiting Puerto Rico. He investigated campground operations in the United States and developed detailed estimates of investment requirements and operating costs. He maintained contacts with the Puerto Rican authorities and investigated similar campgrounds in other parts of the Caribbean.

David's wife taught in the local schools and he taught one night a week in the local university. In this, their first year out of school, they had very little money to invest, and even lacked the funds to investigate the project more fully.

It appeared that at least $200,000 would be needed to set up the campground, even on a small scale. David prepared a business plan and met with many sources of capital. Although these people were impressed by the apparent profitability of the proposed business, they were concerned about his lack of experience. They were also concerned about their own ability to evaluate or keep in touch with a business in such a distant location.

David Simmons was unable to raise the money and subsequently took a job as an industrial salesman.

Success and Failure

There are many factors that determine the success or failure of a new enterprise. One determinant of success is the strategy of the business, representing the decision about what products or services are to be offered and what markets are to be served. Unless there is a need for what the business offers, it will not succeed, regardless of how well it is managed. Thus, a decision to open one more hamburger fast-food restaurant in a community already saturated with such eating places may be doomed to failure. By contrast, a manufacturer who beats out his competitors by introducing a desirable new type of semi-conductor may have little difficulty in getting established.

Another aspect of strategy relates to how the firm competes—what it emphasizes to achieve a competitive advantage. Consumers are already dealing with established businesses. Why should they switch to a new firm? Successful new businesses compete in many ways. Some offer a new service not previously available, such as the first racquetball club in a city. Some offer broader product lines or more service, such as the supermarket offering free coffee, package delivery to cars, and unusually good meat. Some new firms compete primarily on price, taking advantage of their low overhead to underprice competitors. Regardless of the specific strategy, it must give the new firm an advantage in competing for some group of customers.

How do entrepreneurs develop successful strategies? Often, they draw upon experience in pre-

vious jobs, as they observe how existing firms compete in satisfying consumers' needs. Of course, awareness of a need is not enough. A strategy must be based upon the capabilities of the new business. In every business, certain things must be done well. For instance, if it is to be a restaurant offering superb French cooking, there must be an excellent cook, capable of preparing those meals. The new business typically reflects the strengths and weaknesses of the entrepreneur. If the prospective founder is a skilled automobile mechanic, then he probably should consider a business connected with automobiles, rather than a French restaurant.

There are two ways of getting into businesses which are less dependent upon the skills of the entrepreneur. One is to purchase an existing business, which already has a clientele and may have employees who know their jobs. Another approach is to get into business through franchising. Here, the franchisor (such as Kentucky Fried Chicken or AAMCO Transmission) provides the owner with a strategy and a set of methods that have been tested and proved successful. Even so, some franchises have records of success and others do not.

Success is also related to the characteristics of the entrepreneurs. A number of prior studies have examined the extent to which the prior education and experience of the founder are related to later success. In general, founders who have more education and who have relevant experience in the same industry are more successful. There are variations in the findings. Qualities such as determination, energy, and an ability to learn from previous experiences can also make a difference. Companies which are started by teams of two or more founders are, on the average, more successful. An entrepreneur who is experienced in marketing can work with another who has manufacturing strengths and, together, they can build and sell their product better than either could alone. Of course, some businesses have sales sufficient to support two or more owner-managers and others do not.

Businesses which have more initial capital also tend to be more successful. Presumably, additional capital gives the new firm a longer period in which to work out its problems and survive. Of course, more initial capital may also reflect greater success in raising money because of a more impressive strategy and management team.

More successful entrepreneurs tend to seek advice from outside professionals, such as bankers, lawyers or accountants. Furthermore, they develop skills in using these professional advisors. This includes learning what specific advice they need and seeking professional help in anticipation of problems.

We should recognize that entrepreneurs may start businesses for different reasons and that "success" may have different meanings. Some founders are essentially craftsmen, good at performing plumbing repairs or selling insurance. Some primarily want to be associated with a particular activity, such as selling antiques or running a tennis club. Essentially, their businesses are vehicles for them to carry out their professions or pursue an interest. Their management methods are informal. Their businesses usually do not grow very much, nor are they expected to.

Other businesses are launched by more managerially oriented founders. Their founders may have more managerial experience, more capital, and the expectation that their businesses will grow. From the start, they are more concerned about establishing those managerial methods, including record-keeping, which will support a large business. As might be expected, these businesses tend to experience greater growth.

Putting It Together

How does it happen that particular people start their own businesses at certain times and places?

Early experiences shape a person's personality and view of life. They affect that person's attitudes toward risk-taking, drive for achievement, and belief in the ability to control one's destiny. The extent to which that person feels that he or she can start a business is influenced by role-models within the family and among fellow-workers with whom the potential entrepreneur can identify. Education and the specific jobs a person takes may suggest particular business opportunities. They also help to make the entrepreneur more or less prepared to take on the great number of tasks involved in starting and managing a new business. Finally, the availability of needed services or supplies, and the accessability to capital may create a climate more or less favorable for the establishment of a new firm.

At any time and in every region, some people are in the process of planning or starting businesses. Many of these are unsuccessful. However, others represent well-conceived ideas, developed by entrepreneurs who have the preparation, the resources, and the determination to make their businesses succeed. As these entrepreneurs pursue their individual dreams, our society benefits from their hard work, their creativity, and their vitality.

Entrepreneurship: Starting a New Business

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He is author or co-author of five books on entrepreneurship or small business management. He has also published a number of articles on entrepreneurship, on strategic planning, and on the management of technology. He has served on the Federal Advisory Committee on Industrial Innovation and as Chairperson of the Division of Business Policy and Planning of The Academy of Management.

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